E COPY

Office-Supreme Court, U.S.
FILED
AUG 23 1961
JAMES R. BROWNING, Clerk

No. 224

In the Supreme Court of the United States

OCTOBER TERM, 1961

ESTATE OF A. GOUBIELLI, DECEASED, THE HANOVER BANK, EXECUTOR, AND HELENA GOUBIELLI, SURVIVING WIFE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

JACOB A. AND BERTHA L. GOLDFARB, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

ARCHIBALD COX,
Solicitor General,
LOUIS F. OBERDORFER,
Assistant Attorney General,
MEYER ROTHWACKS,
DOUGLAS A. KAHN,
Attorneys,
Department of Justice,
Washington 25, D.C.

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 224

ESTATE OF A. GOURIELLI, DECEASED, THE HANOVER BANK, EXECUTOR, AND HELENA GOURIELLI, SURVIVING WIFE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

JACOB A. AND BERTHA L. GOLDFARB, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

These cases present the question whether the amount of the amortizable bond premium deduction permitted by Section 125(b) of the Internal Revenue Code of 1939 should be computed by reference to the regular redemption price of the bonds, rather than in terms of a lower "special" call price.

In 1953, the taxpayers purchased public utility bonds which were callable on 30-days' notice. Since

the bonds could be redeemed at the "regular" redemption price from the general funds of the utility, the company's right to redeem at that price was unrestricted. The company was also authorized to redeem the bonds at a lower "special" price; however, that right was severely limited by language in the indentures providing that redemption at the special price could be made only from certain funds narrowly defined therein. (Pet. App. 18-20.) The record demonstrates, and the courts below found (Pet. App. 5, 12, 21), that, owing to this restriction, there was no likelihood of a redemption at the special call price during the period when taxpayers held the bonds.

Shortly after taxpayers acquired the bonds, they sold them at a slight loss. (Pet. 5, 7.) Prior to sale, they had taken a bond premium deduction pursuant to Section 125(b), computing the amount of premium by subtracting the amount payable on redemption at the special call price from their basis in the bonds. The Commissioner rejected this method of computation and ruled that the amount of premium should be determined by reference to the regular redemption price, rather than the special call price. (Pet. App. 19-20.) The courts below have sustained the Commissioner's view.

Section 125(b)[1] of the Internal Revenue Code of 1939 provides in relevant part that "the amount of bond premium, in the case of the holder of any bond,

---

[1] This subsection was added by Section 128(b) of the Revenue Act of 1942, c. 619, 56 Stat. 798.

shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or on earlier call date * * *." Concededly, taxpayers' use of the special call price does not offend the literal language of the statute. However, this special call provisions in the bonds have only very limited use and, as previously noted, in the circumstances of this case there was no likelihood that a call would be made at that price.

The Congressional purpose in enacting Section 125(b), as evidenced by the legislative history, was to give statutory recognition to the sound accounting practice of amortizing bond premiums and to permit a portion of the interest received to be treated, for tax purposes, as a restoration of capital. See *Commissioner* v. *Korell*, 339 U.S. 619, 621. Taxpayers' application of an unrealistic call price—*i.e.*, a price at which there was no likelihood of redemption at the time in question—was inconsistent with the Congressional purpose, and the courts below properly construed the Act to preclude such a distorted computation. The decision below carries out the precept that statutes should be construed according to the policy of the legislation as a whole.

The issue is not one of continuing importance since Section 13 of the Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606, amended Section 171 of the Internal Revenue Code of 1954 (the successor to Section 125(b)) in a way which precludes the use of a special call price to obtain an increased premium

deduction.' The amendment, however operates only prospectively, and there is a significant amount of revenue (approximately $5,500,000) dependent upon the resolution of this matter. There are now pending 21 docketed and 110 non-docketed cases involving the point. We also note (as did the court below) that there is a decision of the Sixth Circuit which is in direct conflict with the instant case. *United States* v. *Parnell*, 373 F. 2d 943 (C.A. 6th), affirming, *per curiam*, without opinion, 197 F. Supp. 976 (M.D. Tenn.).[2] And see *Evans* v. *Dudley*, 128 F. Supp. 9 (W.D. Pa.), pending on appeal to the Third Circuit.

Although, as indicated above, the issue is of limited and dwindling importance in light of the 1968 amendment of the statute, we do not oppose grant of the writ since it appears (a) that there is a direct conflict among the circuits and (b) that there is still a substantial body of pending litigation involving the same question.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

MELVIN ROTHWACHER,
DOUGLAS A. KAHN,
Attorneys.

AUGUST 1969.

---

[1] The amended version of Section 171 requires that the amount payable on maturity be used in computing the bond premium. The old price may be used only if it results in a smaller premium.

[2] The finding of fact and conclusions of law of the District Court are reported at 3 A.F.T.R. 2d 665.